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Forward-looking Disclosure and Corporate Governance Characteristics: Evidence from China.

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ABSTRACT
This paper investigates the relationship between forward-looking disclosure (FLD) and a range of corporate governance characteristics in the Chinese stock markets. It finds that the implementation of certain monitoring and control mechanisms, such as independent directors on the board of directors, can improve the extent of FLD. However, separating the roles of the CEO and the chairman of the board of directors is of little help in explaining any improvement in FLD. In contrast, ownership structure appears to play an essential role in determining FLD policies. Indeed, listed firms with high levels of foreign ownership tend to disclose more forward-looking information. Of particular interest, the association between state ownership and FLD is likely to be non-linear, and the inflection point at which the association becomes negative occurs at a state ownership over 38%. In summary, this study provides new evidence on the impact of FLD on corporate governance characteristics on in China's unique institutional environment.

Keywords: Forward-looking Disclosure, Corporate Governance Characteristics, Firm Characteristics, Information Asymmetry, and China

1. Introduction

Under the principal agent model, information asymmetry can considerably influence the contractual relationship, as agents who benefit from their private information lack incentives to reveal their insights. As such, there is a demand for corporate information disclosure by the principal and other information users (Beyer et al., 2010; El-feky, 2016). As a vital source of corporate information, forward-looking disclosure (FLD) can be an essential factor to assist information users to better understand what a firm's previous and present performance may be in the future (Bozzolan et al., 2009; Robert, 2010). In recent years, the research on forward-looking narratives in financial reports has been gaining increasing prominence. However, most studies focus on the usefulness, predictive value, and value relevance of FLD in developed markets (Beyer & Dye, 2012; Wang & Hussainey, 2013; Athanasakou & Hussainey, 2014). The research on FLD in emerging markets is sparse.

China is an interesting case because of its unique institutional environment. For example, listed Chinese firms typically have a more complex ownership structure than those in the West, and a considerable proportion of listed companies' shares are held by the government. Concentrated state ownership can impede corporate information transparency and trigger conflicts of interest between the state and minority shareholders (Su et al., 2008). Consequently, the Chinese government has recently imported a stream of advanced corporate governance mechanisms from developed nations, with the aim of strengthening the internal monitoring and control of listed firms and improving the information environment of Chinese stock markets. In the meantime, Chinese accounting standards (CAS) have been gradually harmonized with international accounting standards (IAS/IFRS). Moreover, the China Securities Regulatory Commission (CSRC) issued the Principles of Contents and Formats for Financial Disclosure by Listed Chinese Firms in 2002, requiring a forward-looking statement to be provided in financial reports. Additionally, the government has recently issued a series of polices on equity incentive plans for listed firms to mitigate the interest conflicts of the agent and the principal and to facilitate corporate information transparency. However, reforms in the legal and political systems have largely lagged, as a result of the government's concerns regarding losing control of large listed firms and the safety of state assets. Therefore, while the economic system is largely market-oriented, the legal and political systems are still strongly influenced by the communist ideology (Allen et al., 2005). The unique features of China's institutional environment, along with the development of FLD regulations by the CSRC, provides an opportunity to investigate the impact of improved corporate governance and FLD by listed Chinese firms.

The following observations have been made from an analysis of a sample of SHSE (Shanghai Stock Exchange) listed firms' forward-looking statements and financial data over the period 2010–2014. First, although most of listed firms have complied with the CSRC's disclosure regulations by providing a forward-looking statement in their financial reports, these statements contain far more qualitative information than quantitative. Second, consistent with early studies, this investigation finds that the extent of FLD is positively associated with foreign ownership (Wang et al., 2011), independent directors (Beeks & Brown, 2006). Interestingly, the impact of state ownership on FLD is likely to be non-linear. Initially, the impact is positive when the level of state ownership is lower than 38% (the inflection point). However, the impact becomes negative when the state owns more than one-third of listed firms' equity. In contrast to the study by Ding, Zhang and Zhang (2007), this study does not find any non-linear association between managerial ownership on FLD for SHSE-listed firms. Also, it finds that separating the roles of the CEO and chairman of the board of directors is of little help in explaining any improvement in FLD.

The contribution of this study to corporate governance and disclosure research lies in the following areas. First, it reconciles and extends the ongoing research on the determinants of corporate disclosure in developing markets (Eng & Mak, 2003; Gul & Leung, 2004; Bai et al., 2004; Beeks & Brown, 2006; Wang et al., 2011; Chen et al., 2016). To the best of the author's knowledge, this is the first research paper that investigates the impact of corporate governance on FLD in a large emerging market. This study provides new evidence of a non-linear association between state ownership and FLD. Second, it examines the success of the Chinese government's importation of a wider range of corporate governance mechanisms than prior studies have done (Yeh et al., 2009; Wang et al., 2011; Chen et al., 2016). This study therefore increases our understanding of the determinants of corporate disclosure in an institutional environment that is characterized by concentrated state ownership and complex ownership structures.

The remainder of this study is organized as follows: The next section reviews developments in China's accounting and corporate governance regulations, previous corporate governance and disclosure research, and develops the study's hypothesis. The sample selection and research methodology are presented in Section 3, and Section 4 reports the empirical findings and analysis. The final section summarizes and concludes the study.

2. Literature review and hypotheses development

2.1 Corporate Governance in China's Stock Market

In accordance with the economic liberalization and reform policy introduced by the Chinese government in the late 1970s, the SHSE and Shenzhen Stock Exchange (SZSE) were re-established in the early 1990s, aiming to modernize ailing state-owned enterprises (SOEs). However, they remain relatively underdeveloped and many listed companies are still directly or indirectly owned or controlled by the state, raising the possibility of conflict of interest between the controlling shareholders and outside investors (Su et al., 2008). Moreover, while (La Porta et al., 2002) classify China's legal system as being of German civil law origin, a unique feature of China's legal tradition is that the judicial system is not independent from the government's administrative system, and politics and adjudication are often mixed (Chen et al., 2014). Indeed, private property rights were recognized by China's legislative system for the first time in March 2004 during the second session of the Tenth National People's Congress Meeting. However, the definition and explanation of private property rights within listed Chinese firms remain "fuzzy", and violation of private property rights by the government, especially at the local government level, remains relatively common (Sanders & Chen, 2005; Deng, 2009). Given the concentrated state ownership, unclear laws governing private property rights, and a lack of judicial independence, China's political institutional norm is in favor of protecting state interests instead of the rights of individuals. Hence, corporate managers and auditors have little incentive to actively communicate with minority or individual investors, which can lead to high levels of information asymmetry (Brown et al., 2011; Chen et al., 2014).

China's old accounting system, borrowed from the Soviet Union in the 1950s, had been a tool to facilitate the government's administration of SOEs and to safeguard the state's interests. It was therefore ill-equipped to meet the needs of stock market participants for comprehensive information for investment decision-making (Bozzolan et al., 2009). Thus, the Ministry of Finance (MoF) issued a series of accounting reforms commencing with the Accounting Regulations for Experimental Listed Companies and the Accounting Standards for Business Enterprises (ASBE) in 1992. These regulations borrowed many accounting principles from Western accounting, the International Accounting Standards Committee. Further regulations in 1998 (Accounting Regulations for

Listed Companies) and 2000 (revised ASBE) brought "accounting practice in China more closely in line with international practices, including a requirement to recognize impairment losses on receivables, inventories, investment, fixed assets, intangibles, and other assets" (Pacter & Yuen, 2001, p.1). Similarly, the MoF approved four auditing pronouncements in 2002 (Specific Independent Auditing Standards, Equivalent International Auditing Standards, Independent Auditing Practice Pronouncements, and Equivalent International Auditing Standards) largely based upon international auditing standards. While these regulations succeeded in bringing Chinese accounting and auditing more into line with international accounting and auditing practices, some significant differences still existed with Chinese accounting rules, generally resulting in less informative accounting information. For example, there were very few requirements for fair value accounting.

In line with the government's economic policy, new corporate governance rules also were introduced, initially through the State-owned Industrial Enterprises Law of China (SOEs Law) in 1988. As Tam (2000) documented, this development "has taken a top-down legalistic approach by transplanting the basic structures of corporate governance from the external market-based model found in Anglo-American systems" (p.53). However, while these corporate governance rules have been introduced, the system of related laws and regulations that ensure the efficiency of the corporate governance model have not been effective, and the government focuses rather less on how the corporate governance concepts and practices are interpreted and applied in the Chinese social, economic, and legal context (Lin & Li, 2008). For example, there is a need for an impartial judicial system that effectively protects the interests not only of controlling shareholders, but also of minority shareholders as well as active markets for corporate control and managerial talents (La Porta et al., 2002). As a result, the Chinese corporate governance system, despite importing the "best practices" from the West, does not work in their proposed way. The highly concentrated state ownership triggers interest conflicts between minority and controlling shareholders, as there is a growing concern that the government may make political objectives the top priority over the corporation's commercial interests, and then potentially misuse its controlling shareholder position to expropriate the minority shareholders' interest (Su et al., 2008). To mitigate the interest conflicts between the government and other shareholders, the CSRC has issued the Code of Corporate Governance of Listed Firms in January 2001 and revised it in October 2005. The Code was especially designed to protect minority shareholders' interests by requiring the controlling shareholder(s) not to act in a detrimental way to other shareholders' legal rights and interests, such as by taking advantage of their position to adversely restructure the listed company's assets. Furthermore, the Code stresses the importance of the timeliness and accuracy of corporate information disclosure. It particularly points out that listed firms should not only disclose the compulsory information mandated by regulations but reveal other information that may impact the decision-making of shareholders and stakeholders. Obviously, this aims to introduce a solid corporate governance system by elevating the requirements on corporate information disclosure and tightening the supervision of corporate management.

In addition to the development of new corporate governance rules, the CSRC issued new corporate disclosure regulations—the Administrative Measures on Information Disclosure by Listed Firms (AMID)—in January 2007, which came into effect immediately. Considering the new disclosure regulations, all listed firms are required to make periodic disclosures of their business activities, financial performance, forward-looking narratives, corporate governance and ownership structure. Moreover, listed firms must publish their quarterly reports within one month following the end of the first and third quarters of a fiscal year, and interim reports within two months following the end of the first half of the fiscal year. Annual reports are required to be made publicly available within three months following the end of a fiscal year and be audited by a qualified CPA firm. However, quarterly reports are free from the external audit requirement, while interim reports need to be externally audited only if listed firms plan to pay dividends, transfer reserves into share capital, or use reserves to offset losses in the next half of the fiscal year (Chen et al., 2014; Chen et al., 2016). Furthermore, to improve the accountability of periodic reports, senior managers and directors are required to sign their consent or dissent with the reports. If external auditors issue a modified audit opinion, directors are required to provide a specific explanation on the matter. Apart from these periodic reporting requirements, listed firms need to file specific reports on "major events" that are not known to investors and may considerably affect the price of listed firms' stock. Previous studies suggest that the 2007 AMID has had a positive impact on the information environment in the Chinese stock markets. For example, Gong and Marsden (2014) report strong evidence that the 2007 AMID significantly increased the level of price-sensitive information disclosed by listed firms.

2.2 Hypothesis Development

Because of the separation of ownership and control, the principal engages the agent to perform services on behalf of the principal, which involves the delegation of some decision- making authority to the agent. Once the contractual relationship is established, the agent obtains information on the environment that will determine which effort level is the most adequate (Jensen & Meckling, 1976). However, it is difficult for the principal to observe the agent's effort and to know whether the agent's effort is optimal. Under information asymmetry, the agent may act in his/her own best interests, rather than those of the principal. This can cause the problem known as "moral hazard with hidden information". The principal therefore establishes various monitoring and control mechanisms, such as corporate governance, to mitigate this problem and improve corporate transparency (Eng & Mak, 2003; Gul & Leung, 2004; Beeks & Brown, 2006).

There is much evidence that financial reporting and disclosure are primarily determined by the preparers' incentives, which are shaped by the institutional environment, including corporate governance, ownership, and control characteristics (Ball et al., 2003; Ball, 2006; Dobler, 2008; Heitzman et al., 2010). Given the rapid changes in China's corporate governance practices in recent years, coupled with the unique features of the Chinese economic, political and legal environments, this study develops the following research hypotheses, presented below.

2.2.1 Ownership Structure

The ownership structure of a company is likely to affect its disclosure policy in several ways. For instance, with dispersed ownership structures, German and French companies have more concentrated ownership structures, and block holders rely on insider monitoring mechanisms to obtain corporate information. Financial reporting and disclosure therefore appear to be less in demand in these Code Law countries (La Porta et al., 2002; Archambault & Archambault, 2003; Armstrong et al., 2010). In contrast, US and UK companies tend to use market mechanisms to discipline managers and alleviate agency costs through improved corporate disclosure (Pratt & Storrar, 1997). A stream of empirical studies has investigated the relationship between disclosure and ownership structure in specific countries, with mixed results. For example, Eng and Mak (2003) document that the block holder ownership of Singapore listed firms is not related to disclosure, while Fan et al., (2007) report that concentrated ownership has a negative impact on the informativeness of earnings in East Asian nations.

Chinese firms typically have a more complex share ownership structure than in the West, with shares being of four types: non-tradable state shares; legal person shares, which are held by other SOEs and tradable with the approval of the CSRC or the government; domestic individual or A-shares, held by private Chinese citizens; and employee shares, which are non-tradable until the firm allows them to be traded. In addition, some firms also have foreign shares, whether B-shares (listed on the SHSE or SZSE), H-shares and Red- Chips (listed on the Hong Kong Stock Exchange), L-shares (listed on the London Stock Exchange), or N-shares (listed on the New York Stock Exchange).

Most listed Chinese firms were initially state-owned, and the state still has a strategy of control of "large and crucial" industries. Thus, approximately 30% of listed firms' shares are directly held by the government, 30% by legal persons and 30% by the general public. This concentrated state ownership could impede the development of high-quality corporate disclosure, as the government and its agencies are insiders who can directly obtain private information from entities (Armstrong et al., 2010). Furthermore, the preponderance of state ownership may result in less effective management monitoring and internal control, which is likely to also negatively impact on corporate disclosure. However, some early studies argue that block holders could be effective monitors of a firm's activities, because they frequently retain the ability to intervene in the firm's strategic decisions, and then have incentives to ensure an information environment sufficiently transparent to remain well informed about the firm's activities (Klein, 2002; Borokhovich et al., 2006). Therefore, block holders are willing to improve corporate disclosure for their own ends, such as to boost the share price if they have good news that is unknown to outsiders, or to lower the cost of equity capital (Robert, 2010). Indeed, Wang et al., (2011) report that the level of voluntary disclosure by B-share firms is positively associated with state ownership. Given that previous studies provide mixed evidence, it is expected that:

H_1: There is a relationship between forward–looking disclosure extent and the level of state ownership.

Since the 1980s, foreign multinational companies have invested heavily in China's manufacturing sector through establishing joint-venture enterprises with domestic firms. However, because of the unfamiliar social environment and their lack of local connections and networks, foreign shareholders are likely to face high levels of information asymmetry (Wang et al., 2008; El-feky, 2017). Therefore, foreign investors are more likely to invest in Chinese firms that are already well-governed and that produce high quality corporate information. Bai et al., (2004) find that listed Chinese firms that issue foreign shares are likely to have higher market value. To alleviate these high levels of information asymmetry for foreign investors, the China Securities Regulatory Commission (CSRC) requires that joint venture enterprises must adopt a "dual reporting strategy", in which their annual reports must be prepared in line with both Casualty Actuarial Society (CAS) and international accounting standards (IAS/IFRS). Furthermore, these enterprises must engage foreign CPA firms (normally Big-4) to audit their annual reports. It is widely accepted that IAS accounting regulations are superior to the CAS, implying that the reconciliation and dual reporting mechanism should improve the reliability of corporate information. Because enterprises with foreign investment must abide by these additional reporting and auditing requirements, they disclose more corporate information. Several early empirical studies report that listed Chinese firms with high levels of foreign ownership tend to voluntarily disclose more corporate information (Xiao et al., 2004; Wang et al., 2008). This leads to the following hypotheses:

H_2: There is a positive relationship between forward–looking disclosure extent and the level of foreign ownership.

Jensen and Meckling (1976) argue that agency costs will decline as managerial ownership rises, because with the increase in managerial ownership, managers will pay a larger share of these costs and are less likely to squander corporate wealth. Moreover, Morck et al., (1988) and Shleifer and Vishny (1997) document that if managers own only a small fraction of shares, managerial ownership can help to align the interests of managers and shareholders by constraining the consumption of perks and engagement in sub-optional investment policies (incentive alignment effect). However, if managers control a substantial fraction of shares, they tend to entrench themselves and then indulge their preferences for non-value-maximizing behaviors (management entrenchment effect). Given the two competing views, a stream of early accounting and corporate finance studies find that the impact of managerial ownership and firm performance is likely to be non-linear (Adams & Santos, 2006; McConnell et al., 2008; El-feky & Nasir, 2017).

In China, managerial ownership falls into the category of employee shares, and the overall level of managerial ownership in listed Chinese firms is relatively low. For example, prior to 2005, a listed Chinese firm was only allowed to allocate up to 2.5% of its total outstanding shares to its employees when going public, and managers could not be granted company shares in any other way, although they could purchase shares on the stock market using their personal funds (Wei et al., 2005; Hu & Zhou, 2008; Hu et al., 2010). Also, unlike Western companies, which use equity incentives widely to align management and shareholders' interests, for most listed Chinese firms, managerial compensation is more closely linked to accounting results, such as sales or profits, instead of the stock price (Hu et al., 2010). Consequently, managers are tempted to engage in opportunistic earnings and disclosure management, to secure their own performance related pay, but at the expense of shareholders' interests (Su et al., 2008). Therefore, since 2005, the Chinese government has issued a series of policies on the implementation of equity incentive plans for listed firms. The main purpose of these policies is to mitigate agency costs by aligning the interests of managers and shareholders, especially minority shareholders. Therefore, with the increase in managerial ownership, managers are less likely to withhold private information and engage in disclosure management.

On the contrary, the management entrenchment hypothesis by Shleifer and Vishny (1997) argues that excessive insider ownership can be counterproductive and result in increased incentives for opportunistic earnings and disclosure management. Moreover, investigating the combination of the incentive alignment effect and management entrenchment effect, Dobler (2008) and Ding et al., (2010) find that there is a relationship between managerial ownership and earnings management. These findings suggest that at a low level of managerial ownership, the incentive alignment effect dominates the management entrenchment effect, but above a certain level, the management entrenchment effect is the dominating factor. Therefore, it is predicted that:

H_3: There is a relationship between forward–looking disclosure extent and the level of managerial ownership.

2.2.2 Proportion of independent directors

The board of directors is another key element of corporate governance, and its composition can considerably affect a company's disclosure practices. There are two different board structures, either the unitary board that is commonly adopted by US and UK companies, or the dual board widespread in mainland EU companies. The UK/US unitary or one-tier board is characterized by the importance of independent directors, who are expected to play the central role of control, acting as a counterweight to executive directors. On the other hand, the feature of the dual board model is the existence of management board. While the management board is responsible for daily business management and business strategy development. As such, independent directors' members need transparent, timely and comprehensive corporate information as a necessary means of management monitoring and internal control. This view is supported by several prior studies documenting that there is a positive relationship between the proportion of independent non-executive directors (INDs) and the comprehensiveness of financial disclosure (Gul & Leung, 2004; Beeks & Brown, 2006). However, Zechman (2010) reports that firm value of large US industrial corporations is negatively associated with board size, suggesting more members on the board of directors could impede the board's efficiency.

China's corporate governance infrastructure has been established recently by borrowing "the best ideas and practices" from developed nations, such as the US, the UK, Germany, and Japan. For example, listed Chinese firms adopt a hybrid model, combining a dual board structure with the presence of independent directors. Indeed, Ding et al., (2010) provide empirical evidence that listed Chinese firms with larger management board size tend to have higher executive compensation but lower pay-performance sensitivity, suggesting poor corporate governance quality. Thus, considering above discussions, it is predicted that:

H_4: There is positive relationship between forward–looking disclosure extent and the proportion of independent directors.

2.2.3 Duality in position

According to the UK Cadbury Report (1992), having no dominant person who can gain "unfettered" control over the board shows that the power between board members is well balanced. Additionally, Donaldson and Preston (1995) document that splitting the roles of the chairman and the chief executive (CEO) demonstrates a corporate performance initiative that can mitigate the principal-agency problem and lead to more independent decision-making. If board members are more independent from senior managers and executives, for effective monitoring and control board directors will require great extents of corporate disclosure. However, Daily et al., (2003) document that the improvements thought to arise from splitting these roles may be a case of wishful thinking, given that there is lack of persuasive empirical evidence to support the above theory in practice. For many listed Chinese companies, the CEO, chairman, and most senior managers and directors are appointed by the controlling shareholder. Therefore, it is unlikely that board members are independent from executive managers, and decision-making by the director board must be in line with the interests of the state, regardless of whether the roles of CEO and chairman are entitled to one person. As such, to split the roles of CEO and chairman is less likely to fundamentally change the features of a Chinese directorial board and improve corporate disclosure practices. Although the separation of the chief executive and chairman roles may not necessarily result in greater corporate disclosure (Daily et al., 2003), this study still anticipates that:

H_5: There is a negative relationship between forward–looking disclosure extent and duality in position.

3. Sample Selection and Research Design

3.1 Sample selection

The sample consists of all Chinese firms listed on the SHSE with financial data available on the China Stock Market and Accounting Research database for the period 2010–2014. This study chooses SHSE listed firms mainly because many of these are restructured SOEs and still under the influence or control of the state. Listed firms' corporate governance information, including ownership structure, the board of directors and supervisory board, is available from their annual reports. Therefore, the listed firms' annual reports were downloaded from the CSRC approved corporate disclosure website. Following previous studies (Wang et al., 2011; Chen et al., 2016), financial institutions were excluded from the sample. These selection criteria yielded a sample of 4,513 firm-year observations.

3.2 Measuring the Extent of FLD

In 2002 the CSRC issued the Principles of Contents and Formats for Financial Disclosure by Listed Chinese Firms, requiring all listed firms to provide a forward-looking statement in their annual reports, and this disclosure regulation was revised in 2007. The revised 2007 disclosure regulation provides certain guidelines on what types, and what extent, of corporate information should be included in the forward-looking statement. However, there is still some space left for listed firms to disclose forward-looking information in a discretionary manner. Moreover, FLD items, such as a listed firm's internal strategies and external competitive and regulatory environment, can be of a very diverse nature. These disclosure items can be characterized by a different degree of verifiability. Hutton et al., (2003) and Mostafa (2016) document that certain forward disclosure information, such as managerial earnings forecasts, are vital to investors' decision-making, because it is verifiable and can enhance the creditability of a forward-looking statement. Therefore, the extent of FLD is measured as 0 for firms that fail to provide a forward-looking statement, 1 for firms that provide such a statement but without any quantitative information (e.g., managerial earnings forecasts), and 2 for firms that provide a forward-looking statement with quantitative information.

3.3 Empirical Model

An ordered probit model was employed to examine the impact of corporate governance on listed Chinese firms'

FLD. Therefore, the extent of FLD is used as dependent variables, and the explanatory variables consist of a range of corporate governance mechanisms. Specifically, following García-Meca and Sánchez-Ballesta (2010) and Ding et al., (2010), managerial ownership and quadratic managerial ownership are used to test the potential non-linear association between managerial ownership and FLD. In addition, following prior studies, the firm size, performance, leverage, market-to-book ratio, and external auditors were added as control variables (Archambault & Archambault, 2003; Beyer et al., 2010; Chen et al., 2014; El-feky, 2017). As such, the detailed form of the test model is presented below, and Table 1 describes the variables used in this model:

$$\text{Prob}\ (FLD_{it}) = \beta_0 + \beta_1\,\text{STAown}_{it} + \beta_2\,\text{FORown}_{it} + \beta_3\,\text{MANown}_{it} + \beta_4\,\text{MANown}^2_{it} + \beta_5\,\text{BOIND}_{it} + \beta_6\,\text{DUALT}_{it} + \beta_7\,\text{FSZ}_{it} + \beta_8\,\text{ROCE}_{it} + \beta_9\,\text{LEV}_{it} + \beta_{10}\,\text{M/B}_{it} + \beta_{11}\,\text{BIG4}_{it} + \beta_{12}\,\text{INDU}_{it} + \beta_{13}\,\text{INDU}_{it} + \varepsilon_{it}$$

Table 1: Definition and measurement of variables for FLD model

Variables	Full name	Variable Description
Dependent Variable		
FLD	Forward–Looking Disclosure	The extent of FLD, 0 for firms failing to provide a forward-looking statement, 1 for firms that provide such statement but without any quantitative information, and 2 for firms providing a forward-looking statement with quantitative information.
Independent Variables ***(Corporate Governance characteristics)***		
$STAown_{it}$	State Ownership	STAown is percentage of shares owned by states.
$FORown_{it}$	Foreign ownership	FORown is the percentage of shares owned by foreign investors.
$MANown_{it}$	Managerial ownership	MANown is the percentage of shares owned by senior managers.
$BOIND_{it}$	Independent directors	BOIND is the ratio of independent directors to total board size.
$DUALT_{it}$	Duality in position	DUALT is dummy variable; 1 if CEO serves as a board chairman, 0 otherwise.
Control Variables ***(Firm Characteristics)***		
FSZ_{it}	Firm size	LogAsst is measured as the natural logarithm of the book value of total assets for the firm i and period t.
$ROCE_{it}$	Return on Capital Employed	ROCE is measured as ratio of profit before interest and tax / (capital & reserves + long-term liabilities).
$LEVRG_{it}$	Firm leverage	LEVRG is measured as ratio of long-term liabilities / (capital & reserves + long-term liabilities).
M/B_{it}	Market to book value	M/B_{it} is the market value to book value of total net assets
$BIG4_{it}$	Auditor type	Big4 is dummy variable, 1 if the auditor is one of the Big4, 0 otherwise.
$INDU_{it}$	Industry dummies	The industry is dummy variable, 1 for manufacturing firms, 0 otherwise.
YDU_{it}	Year dummies	A dummy variable for each year of the sample period from 2010 to 2014.

4. Empirical Results and Analyses

4.1 Descriptive Statistics

The descriptive statistics are presented in Table 2. First, the median and the third quartile of the extent of FLD are 1 and 2, respectively, suggesting that the majority of listed firms have complied with the disclosure regulation by providing a forward-looking statement in their annual reports, but less than half of the statements contain quantitative information. As would be expected, the mean and median of state ownership, at 32.47% and 37.14%, are noticeably larger than those of foreign ownership, at 4.41% and 0. Moreover, the overall levels of managerial ownership in listed Chinese firms are relatively low, as although the maximum value is 66.71%, the mean, median and third quartile are 2.53%, 2.11%, and 4.52%, respectively. With respect to the proportion of independent directors, suggesting that most listed companies have separated the roles of CEO and chairman of the board as the mean and median are 0.11 and 0, respectively.

Table 2: Descriptive statistics of FLD Model

	Mean	Std. Dev.	Minimum	1st Quartile	Median	3rd Quartile	Maximum
FLD	1.39	0.553	0.00	1.00	1.00	2.00	2.00
State Ownership	32.47	21.360	0.00	14.61	37.14	53.64	83.90
Foreign ownership	4.41	8.706	0.00	0.00	0.00	4.14	53.73
Managerial ownership	2.53	2.917	0.00	0.00	2.11	4.52	66.71
Independent directors	0.36	0.053	0.00	0.18	0.33	0.38	0.63
Duality in position	0.11	0.309	0.00	0.00	0.00	0.00	1.00
Firm size	15.87	1.297	13.13	15.07	15.73	16.88	19.75
Return on Capital Employed	14.73	23.090	-256.96	8.50	13.17	19.88	232.07
Firm leverage	18.88	17.384	0.00	2.46	14.21	32.98	63.08
Market to book value	0.74	0.246	0.16	0.59	0.75	0.92	2.01
Auditor type	0.21	0.406	0.00	0.00	0.00	0.00	1.00

4.2 Multivariate analysis

Before running the multivariate analysis, the variance inflation factor (VIF) was used to identify any potential multicollinearity among the independent and control variables. Given the threshold criterion, which is a VIF of 10 (Neter, Wasserman, & Kutner, 1989) or a Pearson correlation of 0.9, Table 3 shows that there is no evidence of multicollinearity. Outliners were identified, and the winsorization technique was used to limit the effect of these extreme values in the data. The (unreported) results obtained using the winsorized data were qualitatively similar to the results (using the original/non-winsorized data) reported here.

Table 3: Pearson correlation matrix

Variables	1	2	3	4	5	6	7	8	9	10	11
1	1										
2	0.58	1									
3	0.18**	0.07	1								
4	0.25	0.13	0.13**	1							
5	0.19***	0.01	-0.05	0.15	1						
6	-0.14**	0.19*	0.23***	-0.01	0.01	1					
7	0.06*	0.35***	0.35***	0.35***	0.09	0.27**	1				
8	0.04*	-0.15	0.10*	0.05	0.04	-0.01	-0.07	1			
9	-0.14**	-0.06	0.16**	-0.06	-0.12**	0.16**	0.04	-0.20***	1		
10	-0.13**	0.04	-0.06	0.25***	-0.02	0.03	0.42**	-0.11**	0.19***	1	
11	-0.57	0.22**	0.42***	0.07	0.02	0.14**	0.48**	-0.01	0.13**	0.14***	1

1:FLD (Forward–looking disclosure); 2:STAown (State ownership); 3:FORown (Foreign ownership); 4:MANown (Managerial ownership); 5:BOIND (independence director); 6:DUALT (Duality in position); 7:FSZ (Firm Size); 8:ROCE (firm performance "Return on capital employed"); 9:M/B (Market to Book value); 10:LEVRG (firm leverage); and 11:BIG4 (Auditor type). ***, ** and * indicate the correlation is significant at the 0.01, 0.05 and 0.10 level, respectively.

Table 4 reports the results of the ordered probit regression between the extent of FLD and a series of corporate governance characteristics. Two models that exclude and include control variables are both significant, with pseudo R-square values of approximately 15.7 percent and 21.6 percent, respectively. Furthermore, consistent with H2, foreign ownership is positively associated with FLD at a significance level of 5% for Model B. This result supports the argument of Owusu- Ansah (1998) that foreign ownership can help local firms to improve their disclosure practices and is in line with the findings of Xiao et al. (2004) and Wang et al. (2008). It also helps explain the findings of Yeh et al. (2009) that minority shareholders appear to be less concerned about agency problems when foreign ownership is higher. Moreover, consistent with H4, the proportion of independent directors is positively associated with FLD at significance levels for both models. This supports the argument that a high proportion of independent directors on the board of directors can enhance the board's effectiveness in monitoring the management team, and thus reduce information asymmetry (Bozzolan et al., 2009; Chen et al., 2016; El-feky, 2017).

Regarding, the remaining hypotheses are not supported. The correlation between state ownership and FLD is not statistically significant. However, the findings are consistent with the argument of Tam (2000), Ding et al., (2010) and El-feky and Nasir (2017) that large management boards appear to operate ineffectively, and Daily et al., (2003) view that separating the roles of CEO and chairman of the board does not necessarily lead to improved corporate disclosure. Furthermore, although managerial ownership is positively associated with FLD and quadratic managerial ownership is negatively related to FLD, the associations are not statistically significant. This may be because managers own a very small faction of listed Chinese firms' equity, the incentive alignment effect of managerial ownership is insignificant.

According to the control variables, the firm size and performance (measured by return on capital employed) variables, are positively associated with the extent of FLD at significance levels of 1% for Model B, as would be expected. Moreover, consistent with prior studies (Bozzolan et al., 2009). Although prior Chinese disclosure studies document that international auditors (normally the Big-4 CPA firms) can help local companies improve their corporate disclosure practices (Wang et al., 2008), this study fails to find a significant and positive association between auditing (BIG4) and FLD. This may be since many listed Chinese firms do not disclose any quantitative and verifiable information in their forward-looking statements. Consequently, there is no need for external auditing if such quantitative information is unavailable in the statements. Moreover, the relationship between market-to-book ratio (M/B) and FLD is negative and significant at 5% level, supporting the argument by Chen et al., (2016) that because of many Chinese firms' dependence on personal networks and connections for business success, high value firms are less likely to voluntarily disclose detailed business information, such as future business strategies and investment plans, as this would expose such valuable networks and connections to the public and increase proprietary costs.

Table 4: Hypotheses and findings for FLD model

	Expected Sign	**Finding Sign**	**Model A**	**Model B**
STAown	+ / –	+	(0.041) 1.50	(0.014) 0.66
FORown	+	+	(0.017) 1.41	(0.115) 2.05**
MANown	+	+	(0.187) 0.73	(0.899) 0.86
MANown2	–	–	(-0.113) -2.33**	(-0.076) -1.45
BOIND	+	+	(4.011) 1.99**	(3.865) 2.73***
DUALT	–	–	(-0.674) -1.08	(-0.797) -1.29
FSZ	+	+		(0.539) 3.46***
ROCE	+	+		(0.027) 2.96***
LEVRG	+	+		(0.018) 0.54
M/B	+	–		(-0.763) -2.12**
BIG4	+	+		(0.239) 0.81
Year dummies				*Included*
Industry dummies				*Included*
F-value			6.40***	6.43***
Adjusted R-squared			15.7%	21.6%
P-values are in parentheses *** p<0.01, ** p<0.05, * p<0.1. Year dummy (2010-2014) are included; also industry type dummy variables are included.				

5. Conclusion

Recent years have witnessed the new corporate governance regulations, the requirements for listed Chinese firms to disclose forward-looking information in their financial reports, along with the new government policies on equity incentive plans. This therefore provides a research opportunity to investigate whether FLD extent is driven by improved corporate governance in China's unique institutional environment setting. Using a sample of all SHSE listed firms for the period of 2010 to 2014, this study finds that, consistent with early studies (Xiao et al., 2004; Beeks & Brown, 2006; Fan et al., 2007; Zechman, 2010; Wang & Hussainey, 2013; El-feky, 2017), high levels of foreign ownership, and more independent directors on the board can strengthen monitoring and control mechanisms and/or improve managers' disclosure incentives, leading to a greater FLD. Furthermore, there is a non-linear association between state ownership and FLD, with the inflection point at around 38%. This suggests that if owning no more than one-third of listed firms' equity, the state can act as an effective monitor and encourage greater FLD for its own ends, but that higher state ownership levels impede the efficiency of internal monitoring and control mechanisms, making FLD less transparent. However, this study does not find any non-linear relationship between managerial ownership and FLD. Moreover, it fails to find any significant correlations between FLD and the dual roles of CEO and chairman of the board of directors. Overall, the results suggest that the extent of FLD is primarily determined by the ownership structure and certain board of director characteristics.

The main contribution of this study to the literature on the determinants of corporate disclosure is to provide new evidence of a non-linear relationship between state ownership and FLD. Also, compared to early Chinese corporate disclosure studies (Wang et al., 2008; Ding et al., 2010; Chen et al., 2016). Furthermore, the empirical findings may be of interest to policymakers for evaluating the use of ownership structure to indirectly control listed firms and the implementation of equity incentive plans to mitigate the agency costs by aligning the interests of managers and shareholders.

6. References

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Appendix A: Forward – Looking Disclosure Index (FLDI).

1.	Qualitative discussion about future capital.
2.	Quantitative discussion about any financial risks.
3.	Qualitative discussion about planned new investment projects.
4.	Quantitative discussion about any industry or market risks.
5.	Qualitative discussion about the business plans that will be taken to achieve the sales target.
6.	Quantitative discussion about any political risks.
7.	Qualitative discussion about the business plans that will be taken to achieve the earnings target.
8.	Quantitative discussion about future capital expenditure plan(s).
9.	Qualitative discussion about the business plans that will be taken to increase the firm's market share.
10.	Quantitative discussion about planned new investment projects.
11.	Qualitative discussion about the firm's future challenges.
12.	Quantitative discussion about the impact(s) of the future challenges.
13.	Qualitative discussion about the firm's future growth opportunities.
14.	Quantitative discussion about the impact(s) of the future growth opportunities.
15.	Qualitative discussion about the firm's next year's operating plans.
16.	Quantitative discussion about the next financial year's cash flows.
17.	Qualitative discussion about the impact(s) of financial risks.
18.	Quantitative discussion about the next year's earning target.
19.	Qualitative discussion about the impact(s) of industry or market risks.
20.	Quantitative discussion about the next year's sales target.
21.	Qualitative discussion about the next financial year's cash flow.